

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1941

No.

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ROBERT H. CORY,

Petitioner,

—*against*—

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

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## **BRIEF IN SUPPORT OF PETITION**

### **I.**

#### ***Opinions Below.***

The opinion of the Circuit Court of Appeals (108-117) is officially reported in 126 F. (2d) 689.

The opinion of the Board of Tax Appeals (6-11) is not officially reported.

### **II.**

#### ***Jurisdiction and Statement of Case.***

The basis of this Court's jurisdiction and facts of the case are stated under headings I and III of the petition, and, in the interest of brevity, those statements are hereby incorporated in and made a part of this brief.

**III.*****Specification of Errors.***

1. The Circuit Court of Appeals erred in holding a trust, which was irrevocable for ten years or in the alternative for life, to be a "short-term" trust within the meaning of the rule enunciated by this Court in *Helvering v. Clifford*, 309 U. S. 33.
2. The Circuit Court of Appeals erred in holding that emancipated adult sons of a grantor of a trust are members of the grantor's "intimate family group" under the rule of the *Clifford* case.
3. The Circuit Court of Appeals erred in holding that an unexercised power to change administrative provisions of a trust agreement gives a grantor complete dominion over the trustee and control over the income of the trust.
4. The Circuit Court of Appeals erred in holding that a reserved power to appoint a substitute trustee in the event, and only in the event, of the death or resignation of the original independent trustee gives the grantor power to appoint himself such substitute trustee and gives him control over the corpus of the trust within the meaning of the rule enunciated by this Court in *Helvering v. Clifford*.
5. The Circuit Court of Appeals erred in extending the rule of *Helvering v. Clifford* to a case involving a ten-year term, an independent trustee and complete absence of control by the grantor over determination of what is income and where the income shall be distributed.

**IV.*****Argument.***

The statute involved is Section 22(a) of the Internal Revenue Acts of 1934 (c. 277, 48 Stat. 680, U. S. C., Title 26,

Sec. 22), and 1936 (c. 690, 49 Stat. 1648), which provided in part as follows:

*"Sec. 22. Gross Income.*

"(a) *General Definition.*—'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. \* \* \*'"

The leading case relied on by the Court below, is *Helvering v. Clifford*, 309 U. S. 331, which held that income from a "short-term" trust is taxable to the grantor under this statute where the beneficiaries are members of the grantor's "intimate family group" and where the grantor retains "control" of the corpus.

**A.**

*A trust which for 10 years deprives the grantor of all benefits, while subjecting him to the risk of complete loss of the trust property, cannot reasonably subject the grantor to the same presumptions of continued ownership as a "short-term" trust.*

The trusts involved in this case were irrevocable for a term in the alternative of ten years or life. The decision below is that such a trust is a "short-term" trust and accordingly subjects the grantor to the presumption of con-

tinued ownership. This decision, we submit, is inconsistent with the rule as heretofore declared by this Court and unrealistically fails to recognize the risks attendant upon tying up property in trust for as long and unforeseeable a period as ten years.

Both the Congress and this Court have refrained from declaring an inflexible rule as to just where the line should be drawn between trusts classified as "short-term" and trusts classified as "long-term". In *Helvering v. Hormel*, 312 U. S. 552, and *Helvering v. Richter*, 312 U. S. 561, this Court considered a three-year trust and a five-year trust and remanded both cases to the Board for further consideration. Those decisions are based upon the view that apparently even a three-year or a five-year term is not so short as to indicate conclusively that the income should be taxed to the grantor, in the absence of strong evidence respecting other factors. The *Clifford* case involved a five-year trust, and this Court has not held any grantor taxable under the rule of that case upon the income of any trust for a longer term.

It is interesting to compare the British solution of this difficulty, as their experience has resulted in the adoption of a statutory rule of thumb. Under the British income tax law, the income of a trust for a term of six years or less is automatically taxable to the grantor and the income of trusts for longer terms is not (12 & 13 Geo. 5, ch. 17, §20; L. R. Stat., Vol. 60, p. 373).

In the absence of a six-year rule of thumb, it is clear, we submit, that a ten-year term deprives the grantor of so many of the benefits of full ownership that he should not be treated as the owner for income tax purposes in the absence of much stronger evidence of control and intimate family relationship with the beneficiaries than would be sufficient in the case of a "short-term" trust of five or six years and than was present in this case.

## B.

*Where the burden of proof is on the Commissioner, as it was in this case, evidence that the trust beneficiaries were the wife and three sons of the grantor is insufficient to establish that grantor and beneficiaries were members of an "intimate family group".*

There is no presumption that a man's adult son is a member of his "intimate family group". Yet the decision below is apparently based upon such a presumption. Although the learned Court below conceded that the normal burden of proof was reversed in this case,—that the Commissioner had the burden of proving that the beneficiaries were members of the grantor's "intimate family group"—it held that the Commissioner's burden was satisfied by showing "that the beneficiaries were members of the taxpayer's family" (117). It went even further and suggested that the burden was on the taxpayer to show that the beneficiaries were "hostile" if he wished to rely on the claim that they were not members of the grantor's "intimate family group" (117).

There is not one word in the opinion of this Court in the *Clifford* case, or in any other case we have found, which justifies such an interpretation. To say that an emancipated adult son is a member of his father's "intimate family group" unless they are "hostile" to each other, even if the son has a family of his own, a home of his own and an independent income of his own, deprives the phrase "intimate family group" of its normal, natural, generally understood meaning. To say that a grantor of a trust is taxable on the trust income unless the beneficiaries are "hostile" to the grantor is equivalent to saying that all trust income shall be taxable to the grantor, for it is unreasonable to suppose that any person would voluntarily set up a valuable trust for the benefit of his enemies, whether related to him or not.

Even if it could be presumed that the sons were members of this grantor's "intimate family group" at the time the trusts were originally set up in 1929, there could be no presumption that such relationship continued six or seven years later. Indeed, the dissolution of such intimate family groups is a normal development in the American way of life and perhaps particularly so in the case of sons who upon becoming adults seek to make their own way in the world and form new intimate family groups of their own. If the burden of proof had been on the petitioner then it would have been incumbent on him to show that the relationship did not exist in this case during the years under review. However, the burden of proof was admittedly on the Commissioner and no attempt whatsoever was made by the Commissioner to sustain the burden of showing that such a relationship did exist.

If the membership of trust beneficiaries in an "intimate family group" is to be retained as a factor in the determination of taxability of trust income to the grantor, this Court should speedily correct the error of the Court below in treating that phrase as merely a synonym for non-hostility. The term "intimate" was advisedly chosen by this Court in its decision in the *Clifford* case and implies that an additional element beyond mere family relationship must exist. The opinion of the Court below completely disregards this important factor.

Other Circuit Courts of Appeals have been more realistic in determining the existence or non-existence of an "intimate family group" relationship.

*Commissioner v. Armour*, 125 F. (2d) 467 (7th Circuit, Feb. 2, 1942), held a thirty-four year old married daughter, who lived apart from her mother, but had no children of her own, not a member of her mother's "intimate family group" under the rule of the *Clifford* case.

*Suhr v. Commissioner*, 126 F. (2d) 283 (6th Circuit, March 5, 1942), held not taxable to the grantor income from trusts for the benefit of his wife and stepsons where it did not appear that such income was necessary for the support of the beneficiaries.

In *Commissioner v. Central National Bank of Cleveland*, 119 F. (2d) 470 (6th Circuit, 1941), the Court considered the taxability of income from four trusts for the benefit of the wife and children of the settlor. Because taxability under Section 22(a) had not been urged before the Board of Tax Appeals, the Circuit Court remanded the case to the Board so that additional evidence could be introduced (among other subjects) "as to the individual status of members of the Wilson family bearing importantly upon the question whether they constituted an intimate family group". That case apparently presented the usual situation in which the burden of proof was recognized by both sides as being on the taxpayer and therefore the opportunity was given to the taxpayer to present such additional evidence after the case had been remanded. The case is on all fours with the case at bar except that here the burden of proof is admitted by the Court below to be on the Commissioner, who knew he was urging taxability under Section 22(a) at the time of the trial in the Board of Tax Appeals and failed to present any evidence as to the existence of an "intimate family group" other than the exact evidence which was held inconclusive in the *Central National Bank* case, viz., evidence that the beneficiaries were the wife and children of the grantor.

*Commissioner v. Chamberlain*, 121 F. (2d) 765 (2d Circuit, 1941), held not taxable to the grantor income from an almost wholly controlled four-year trust for the benefit of a Legislative Drafting Research Fund of Columbia University in which both the grantor and his co-trustee were professors and intensely interested. The Court's opinion emphasized

the absence of benefit to "immediate relatives" and the non-existence of a "family purpose". There was no suggestion that hostility between the grantor and beneficiary must be shown to take the case out of the *Clifford* rule.

The conflict between those decisions and the decision of the Third Circuit, which is the subject of this petition, should be resolved by this Court before the confusion already created results in an unnecessary volume of additional litigation.

### C.

***The Court below has erroneously confused control by the grantor over administrative provisions of the trust with that type of control over the distribution of income which is an important factor in determination of taxability under the rule of the Clifford case.***

The facts respecting the "control" retained by Cory in the present case and a comparison demonstrating the much greater and more important control retained by Clifford in the leading case in this Court have been set forth in the petition (pp. 13-14, *supra*), and for the sake of brevity will be omitted here. It will be recalled that Clifford retained complete control over the distribution of income during the period of the trust while Cory gave up all vestiges of such control. The fact that Cory retained power to change the administrative provisions of the trust appears to have led the Court below into the erroneous statement (115) that through such power "he could control the purse strings \* \* \*". The Court agreed implicitly that the only sort of control which is important in the present situation is control of "the purse strings". Certainly that is the theory of cases in other Circuit Courts of Appeals which have discussed the "control" factor.

*Jones v. Norris*, 122 F. (2d) 6 (C. C. A. 10th, 1941);  
*Commissioner v. Branch*, 114 F. (2d) 985 (C. C. A.  
1st, 1940);  
*Palmer v. Commissioner*, 40 B. T. A. 1002, aff'd  
without opinion in *Helvering v. Palmer*, 115 F.  
(2d) 368 (C. C. A. 2d, 1940);  
*Whitely v. Commissioner*, 120 F. (2d) 782 (C. C. A.  
3d, 1941);  
*Commissioner v. Buck*, 120 F. (2d) 775 (C. C. A.  
2d, 1941).

Likewise, the power to appoint a substitute trustee in the event of death or resignation of the original independent trustee has been held unimportant in determining taxability under the rule of the *Clifford* case. *Commissioner v. Jonas*, 122 F. (2d) 169 (C. C. A. 2d, 1941).

The opinion of the Court below appears to have been erroneously based upon the assumption that by changing the administrative provisions of the trusts involved in this case, Cory might have forced a diversion of the income to persons or for purposes different from those specified in the trust agreements. Such assumption was plainly erroneous since it disregards the limitation upon Cory's power to change administrative provisions imposed by the same sentence of the trust agreement, which granted the power (47) :

“ \* \* \* but he (Cory) shall not have the power at any time to change the distributive provisions or to affect the beneficial interests created hereunder \* \* \*.”

In any event, recognized principles of trust law would be invoked to curb an abuse of trust purposes through a settlor's reckless use of reserved powers for his own benefit. In *Carrier v. Carrier*, 226 N. Y. 114, which involved a trust

reserving to the settlor far more extensive control than was retained by Cory here, it was made plain in the opinion of Judge (later Mr. Justice) Cardozo that such reserved powers are themselves held in a fiduciary capacity and must be exercised subject to the same equitable principles as are applicable to the independent trustee (in that case a trust company; here an individual). The Court there said, at page 125:

“\* \* \* the creator of this trust had reserved to himself the broadest rights of management. His discretion was to be ‘absolute and uncontrolled.’ That does not mean, however, that it might be recklessly or willfully abused. He had made himself a trustee; and in so doing he had subjected himself to those obligations of fidelity and diligence that attach to the office of trustee. He had power to ‘invest’ the moneys committed to his care. He had no power, under cover of an investment, to loan them to himself. His discretion, however broad, did not relieve him from obedience to the great principles of equity which are the life of every trust (citing cases).”

**The petition for a writ of certiorari should be granted.**

Respectfully submitted,

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Counsel for Petitioner.

Dated: June 9th, 1942.